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Grant Thornton

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The Cut Back Economy

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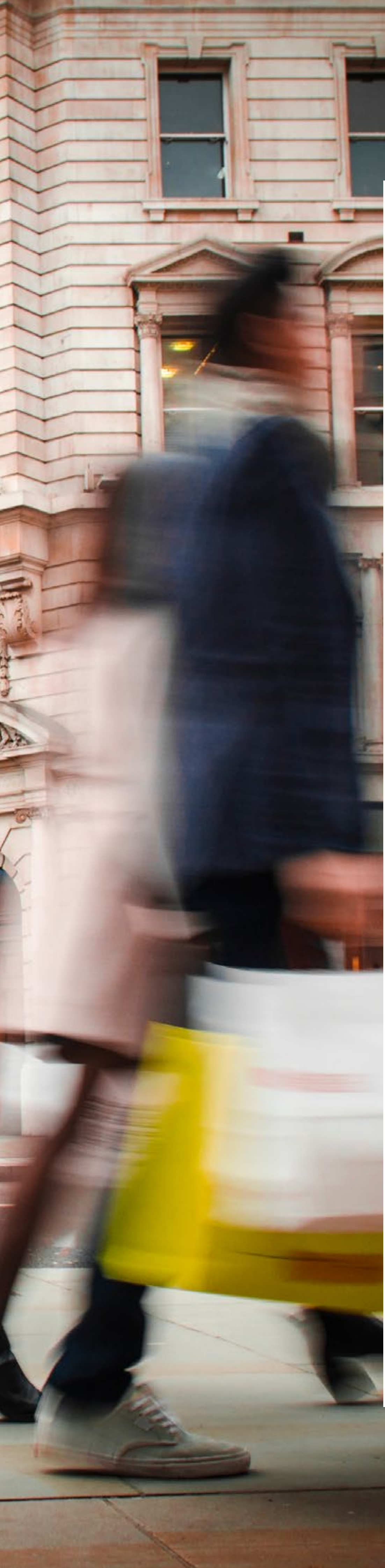
The Cut Back Economy

Assessing the impact of the cost-of-living crisis on the retail and consumer industry

Methodology

In partnership with Retail Economics, the research contains behavioural insights based on findings from a nationally representative consumer panel of UK households.

The sample comprised more than 2,000 adults with survey data collected in May 2022. Any economic modelling and household expenditure data refers to the financial year April 2022 to April 2023 unless otherwise stated.



Introduction

Most consumers are about to experience the tightest squeeze on their disposable incomes within their lifetimes. The everyday cost to power their homes, fill up their cars and pay for weekly food shopping is soaring. Already at the highest level in four decades, inflation is now forecast to hit 11% this year, with the unfolding cost-of-living crisis causing consumer confidence to drop to record lows.

Faced with a tri-pronged attack of rising interest rates, increasing taxes, and rapid inflation, household finances are being tested from all angles, affecting consumers' ability to completely fulfil their wants and needs.

This signals the arrival of a 'Cut Back Economy'. Our research shows almost 9 in 10 UK consumers will be forced to reduce their spending to help cover essentials, whether by trading down, shopping less frequently, or sacrificing certain purchases altogether.

This has huge ramifications for the UK retail and consumer industry, affecting sectors that were among the hardest hit during the pandemic as many businesses are just 'getting back to normal'.

Against this backdrop, there are growing concerns that a combination of tighter monetary policy to combat inflation and ongoing fallout from geopolitical tensions could tip the UK into recession. Whether or not the UK's service-driven economy avoids recession will ultimately depend on the extent to which consumers retrench, making it crucial for businesses to understand the evolution of the Cut Back Economy and resulting changes in consumer behaviour.

This research explores the key drivers and impacts of the cost-of-living crisis on UK retail, leisure and consumer sectors. It identifies the opportunities and risks for brands looking to navigate the Cut Back Economy in order to leverage a competitive advantage in 2022 and beyond.

The report is split into three sections:

The big squeeze

An overview of the macro forces underpinning the cost-of-living crisis and identifies four main Consumer Cut Back personas.

Cut Back Economy landscape

Quantifies the impact of the Cut Back Economy and changing consumer behaviour within retail, leisure and consumer sectors.

Opportunities and risks

Identifies five key themes for retailers and consumer-facing brands to focus on to better navigate the Cut Back Economy.

Part one

The big squeeze

Cost-of-living crisis

The UK economy faces severe headwinds as soaring inflation, slower growth and tightening monetary policy are set against a backdrop of heightened geopolitical tension. For many households, emerging from a global pandemic has only provided temporary relief, only to be replaced by a new reality characterised by economic volatility. As society witnesses the sharpest squeeze on disposable incomes in generations, genuine fears of an oncoming recession are now surfacing.

Stagflation nation

Prices are surging while growth is stalling: the classic hallmarks of stagflation. The distortion of global supply chains since the pandemic, the softening impact of Brexit on UK trade flows, and higher commodity prices are among the culprits.

Inflation was initially expected to be a transitory 'reopening effect' post-pandemic. However, prices have risen at a faster and more persistent pace than anticipated, as the economic aftershocks of the war in Ukraine and lockdowns in China exacerbate existing pressures, hitting consumer confidence.

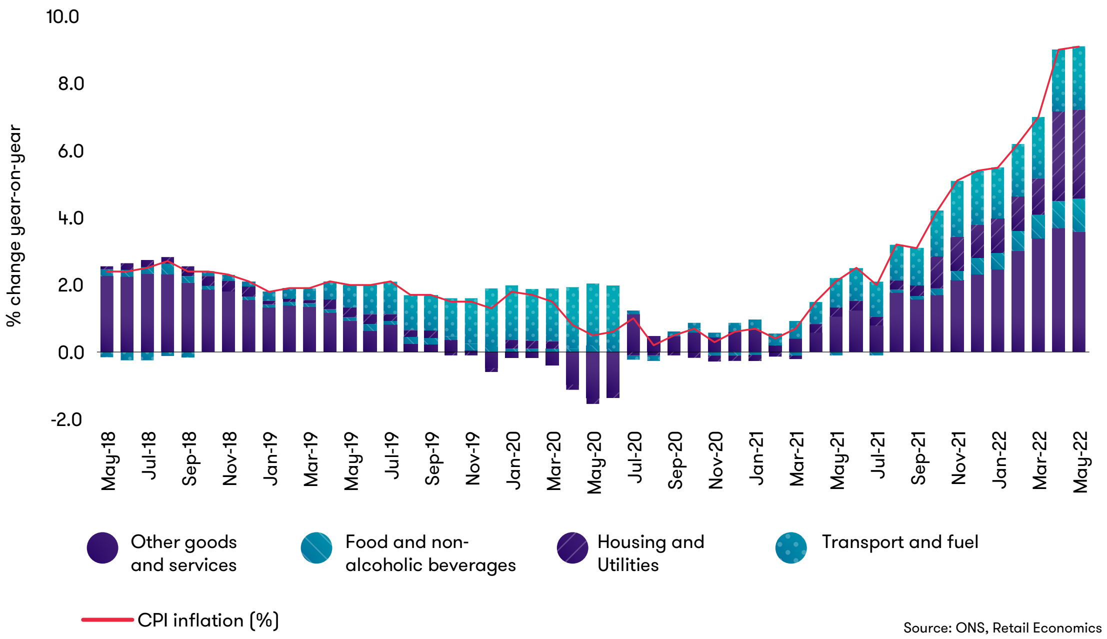
Already at a 40-year high, inflation is now expected to hit 11% before the end of 2022 as a further rise in the energy price cap comes into effect from October 2022 (fig 1). Notably, most consumers would not have experienced this level of inflation during their lifetime.

The Bank of England raised interest rates for the fifth consecutive time in June 2022, reaching the highest level since the global financial crisis, as the bank walks a tightrope between bringing inflation back under control and sustaining economic growth.

Many economists expect the economy to slow rapidly in the upcoming quarters, reaching the verge of a technical recession – two consecutive quarters of negative GDP growth. Reflecting the weaker outlook, the OECD cut its UK growth forecast for 2023 to zero - the lowest in the G20 (except Russia). The combination of a tight labour market, excess savings and government support should help avoid a sharp economic contraction, but considerable uncertainty persists.

Irrespective of whether the technical definition of a recession is met, households will undoubtedly face challenging conditions as the cost of energy, food and imported goods rise significantly.

Fig 1. Inflation climbs to 40-year high driven by surging fuel, food and energy prices



Source: ONS, Retail Economics

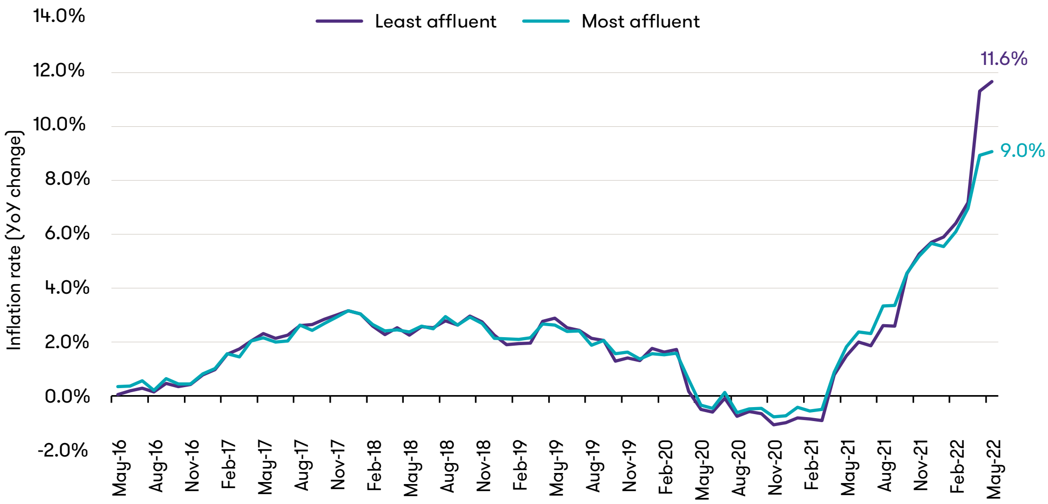
Household polarisation

The impact of the cost-of-living crisis clearly varies by household. Those on lower incomes or burdened with debt are inherently more vulnerable to inflationary shocks. They are also less likely to have accumulated a protective savings buffer compared to more affluent households.

Our research shows that the least affluent* are already experiencing inflation of almost 12%, compared to around 9% for the wealthiest households (fig 2). This reflects the disproportionate impact of rising prices across essentials such as food and energy which are seeing some of the fastest price rises.

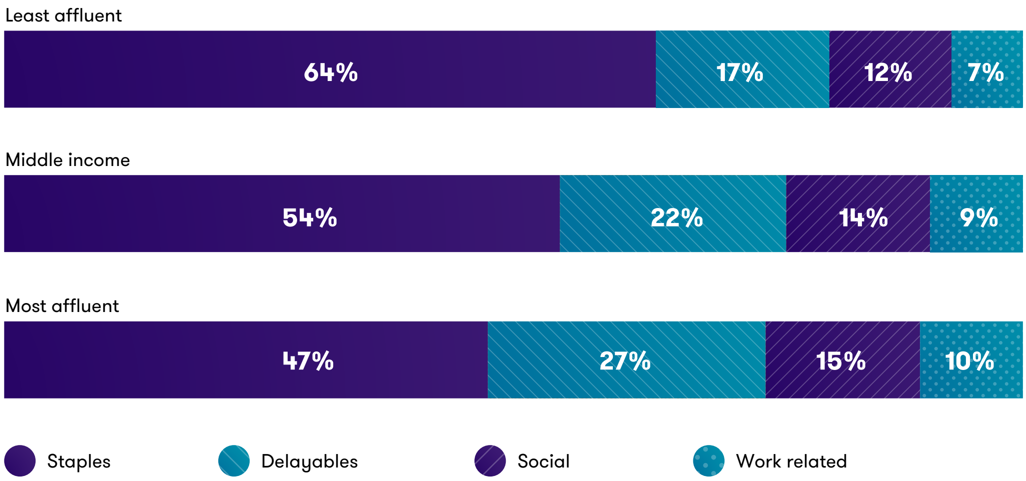
The least affluent spend close to two thirds of their household budget on staples such as food and energy, compared to less than half among the most affluent (fig 3).

Fig 2. Low-income households experiencing higher inflation



Source: Retail Economics Cost of Living Tracker

Fig 3. Low-income households experiencing higher inflation



Source: Retail Economics Cost of Living Tracker

Staples (food and drink, utilities, communication, housing costs), **Delayable** (clothing and footwear, household goods, luxury purchases), **Work-related** (Public transport and fuel), **Social** (air travel, restaurants and hotels).

* Least affluent refers to the poorest 20% of UK households with annual disposable income (after taxation) of less than £15,000. Most affluent refers to the top 20% wealthiest households with annual disposable income over £63,000.

With inflation set to rise further in the months ahead, most UK households face double-digit declines in discretionary income (spare money left over after paying for essentials including food and drink, utilities, communication, housing costs). Although earnings continue to rise, take-home pay is failing to offset price increases across everyday living costs.

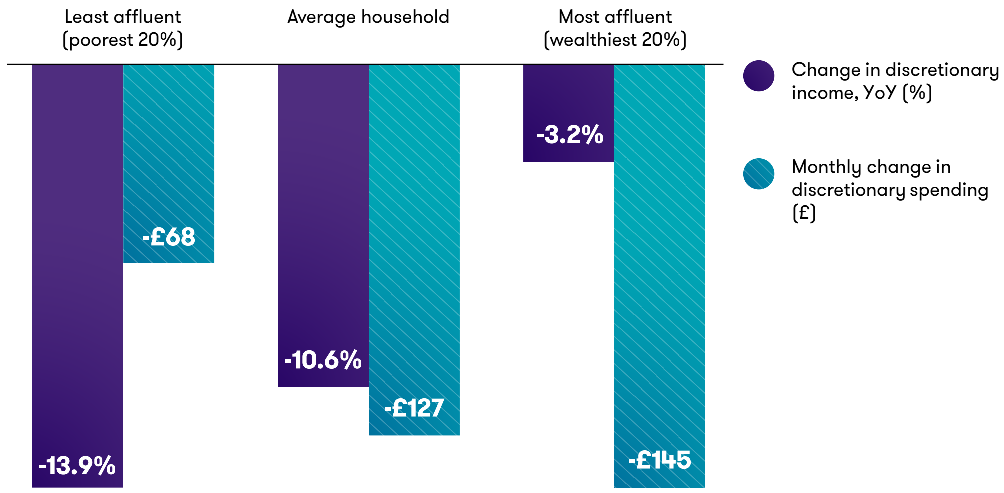
For instance, the Retail Economics Cost of Living Tracker shows the average household saw their spare cash plummet 10.6% in May 2022 compared to last year, leaving them with £127 less to spend on non-essential purchases during the month.

Stronger earnings growth among the most affluent households has helped offset some of the inflationary pressures and supported discretionary income levels. But even the most affluent have come under increasing pressure as national insurance contributions (NICs) step up, with their spare cash available for non-essential purchases falling by 3.2% in May 2022, or £145 per month.

Even a small drop in discretionary income among the most affluent is significant as this consumer demographic is key to the UK economy. While it represents one fifth of consumers, it is responsible for over 40% of total household spending.

Seeing their budgets squeezed, many consumers will adopt recessionary behaviours. They will be forced to either save less, trade down, or cut back spending. Concerningly for the retail and leisure industries (and the wider economy), 41% of consumers expect the current squeeze on living standards to impact their spending habits until at least the end of 2023.

Fig 4. Change in Discretionary income by household – May 2022

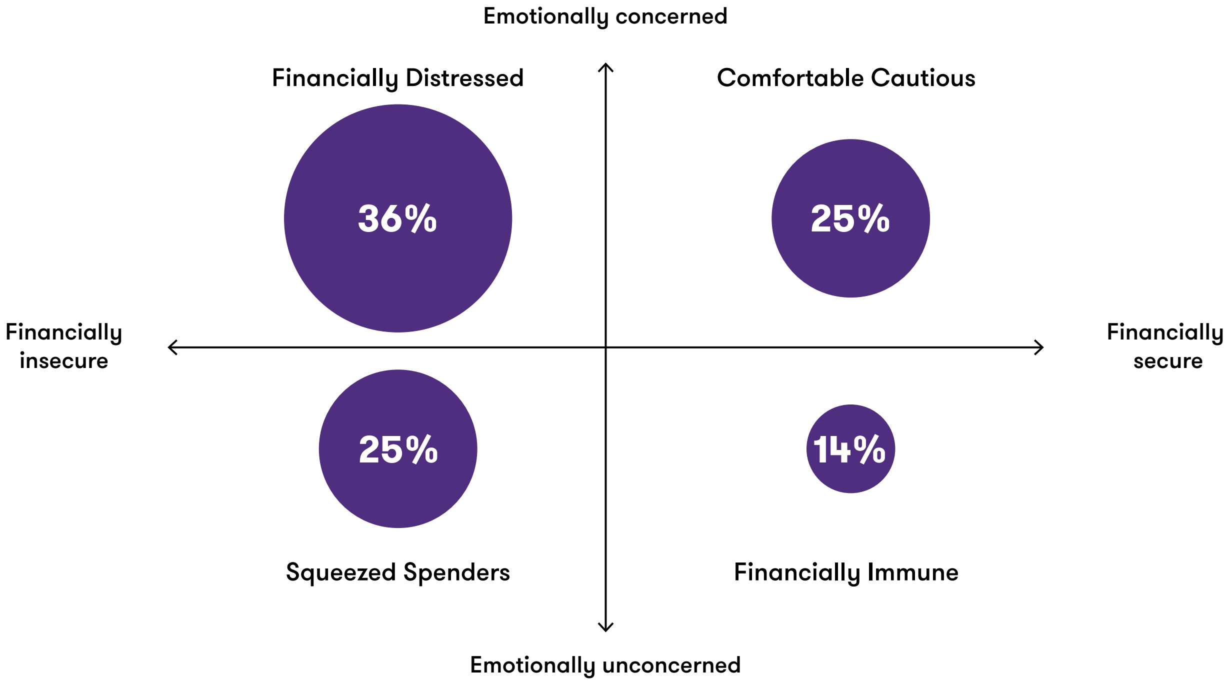


Source: Retail Economics Cost of Living Tracker

Cut Back cohorts

Our research reveals four consumer cut back archetypes (fig 5), based on how UK households perceive the cost-of-living crisis and resultant changes in their spending behaviour.

Fig 5. Change in Discretionary income by household – May 2022



Source: Retail Economics, Grant Thornton

Financially Distressed: 36%
Typically under the age of 45, this cohort are financially insecure and intend to cut back across most (if not all) of their non-essential spending. This is a decision based on necessity rather than choice, as low incomes and/or high debt levels leave little room for manoeuvre to manage rising living costs. Already resorting to extreme measures to be able to afford to pay a bill and cover everyday needs, 'Financially Distressed' consumers are twice as likely to have used a food bank, taken on additional work, or cut back on meals in the last six months.

Squeezed Spenders: 25%
These consumers are also financially squeezed, yet are largely unconcerned by the rising cost of living. This cohort tend to live in the moment, likely to dip into savings, increase their borrowing, or use buy-now-pay-later schemes to make non-essential purchases as they tend to not let money worries impact their spending habits. Ultimately, as cost of living pressures intensify, 'Squeezed Spenders' recognise that making cutbacks and putting on hold major purchases will be necessary, but their carefree attitude makes them reluctant to do so. Typically urban and middle-income, these consumers are a mix of ages.

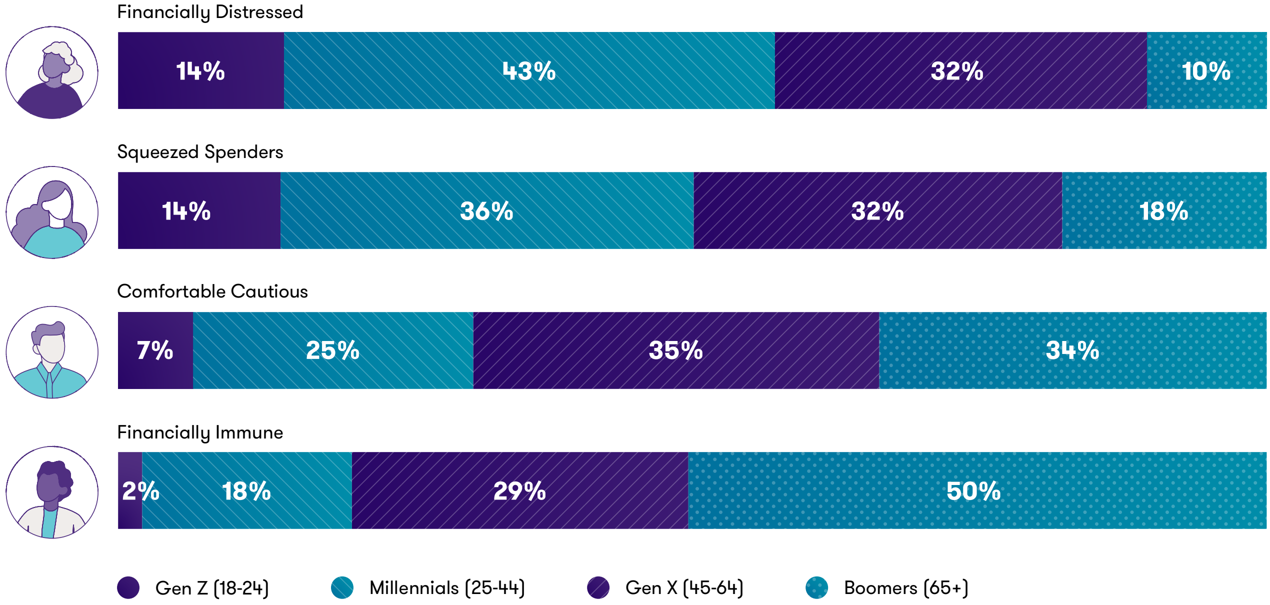
Comfortable Cautious: 25%

'Comfortable Cautious' consumers are financially secure, but the rising cost of living is still a concern on an emotional level. Typically comprising middle-to-higher income households, often with children, this cohort are risk-averse and prefer to adopt a considered approach to spending rather than act impulsively. They will consciously look for deals and switch to cheaper brands in order to cut back across some of their spending, but equally they possess the financial means to go ahead with big ticket purchases. For example, most Comfortable Cautious consumers intend to go ahead with their holiday plans in 2022, unlike the Financially Distressed and Squeezed Spender cohorts that are less financially stable.

Financially Immune: 14%

For this affluent group of consumers, the cost of living crisis has had no financial or psychological impact on their behaviour, and they have no plans to cut back their spending. Most likely over the age of 45, this cohort are cushioned by high incomes and significant savings accumulated during their working life, providing a financial safety net that was further bolstered during the pandemic from fewer travel and social occasions.

Fig 6. Cut Back cohorts by age



Source: Retail Economics, Grant Thornton

Part two

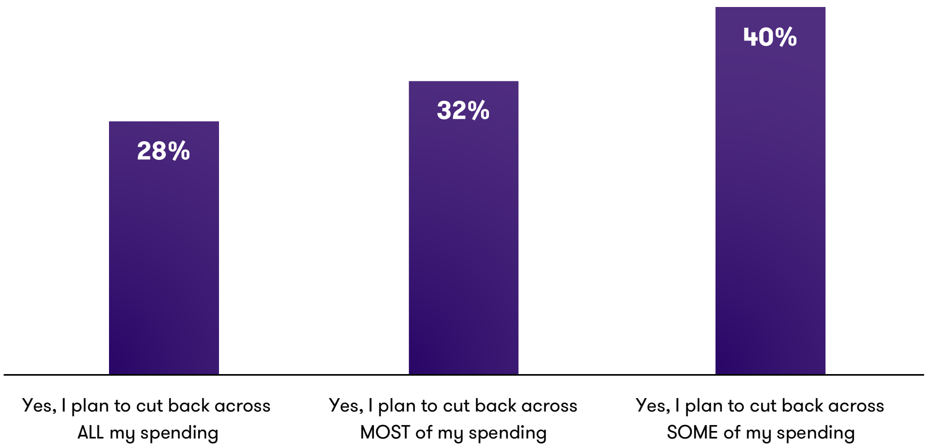
The Cut Back Economy landscape

Quantifying the Cut Back Economy

Our research shows almost 9 in 10 (86%) consumers plan to cut back their spending over the next twelve months due to the rising cost of living. Of those planning to cut back, more than a quarter (28%) intend to do so across all areas of their spending.

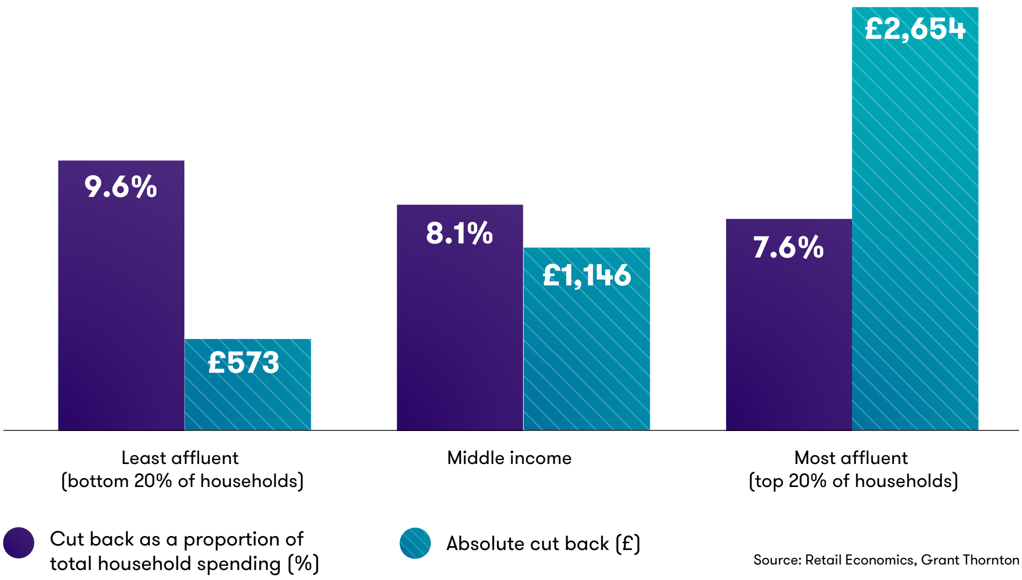
In this context, the Cut Back Economy principally refers to consumer behaviours that aim to reduce spending. This includes switching to cheaper alternatives, shopping or doing an activity less frequently, or cancelling expenditure altogether.

Fig 7. Of those consumers cutting back, more than a quarter plan to do so across all areas of their spending



Source: Retail Economics, Grant Thornton

Fig 8. Size of Cut Back as a proportion of total household spending in FY 2022/23



Source: Retail Economics, Grant Thornton

The least affluent are projected to cut back 9.6% of their annual household spending, compared to 8.1% for the average household (Fig 8).

Even the most affluent (top 20% wealthiest households) are expected to cut back 7.6% of their spending, equating to a £2,654 reduction in value terms over the year.

Collectively, the overall impact of the cost-of-living crisis is set to wipe out a potential £24.9 billion of discretionary spending across UK retail, leisure and consumer industries in the financial year 2022/23 (twelve months to April 2023).

The scale of the Cut Back Economy also varies by different sub-sectors across the retail, leisure and consumer industries. There are different consumer spending priorities based on the nature of the purchase in terms of value and frequency (eg staple v discretionary). Figure 9 explores this in more detail, showing what the Cut Back Economy looks like for different sub-sectors:

Fig 9. Cut Back Economy by sector

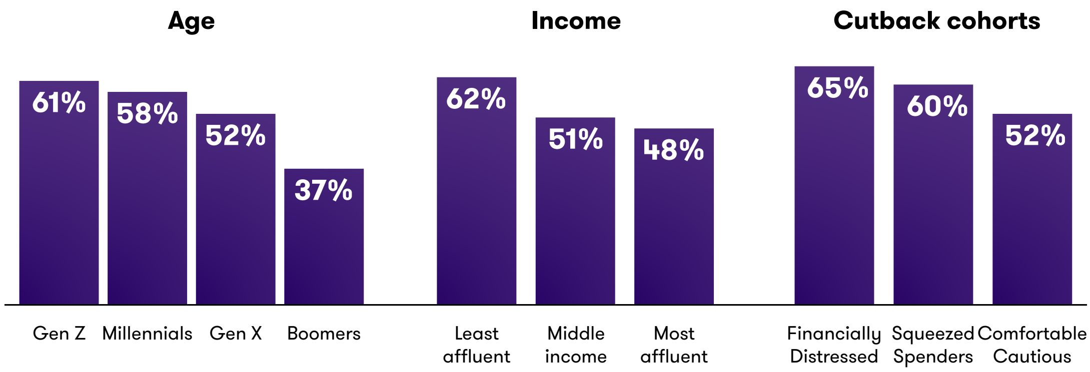
Rank	Sector	Cut back, % of all households	Cut back, % of those planning to spend on this	Cut back, % of annual household spend	Cut back total, £ billion
#1	Grocery	51%	52%	-12.9	-£13.9bn
	The weekly food shop is one of the first and most visible areas that households cut back on. Food prices are rising sharply and as a regular high-frequency purchase, consumers are quick to feel the impact on their budgets. The UK grocery market is also highly competitive, giving shoppers plenty of opportunities to shop around and trade down (eg discounters, private-label).				
#2	Fashion	47%	49%	-10.6	-£3.7bn
	During the pandemic, many consumers became accustomed to buying clothes less frequently, notably formal items and occasionwear. Although the sector has seen a bounce back since restrictions eased, pent-up demand is waning and consumers are once again prepared to deprioritise fashion purchases. This also reflects the fact that many consumers plan to cut back on social events for which they may have previously bought a new outfit.				
#3	Hospitality and leisure	44%	53%	-9.3	-£8.5bn
	Many restaurants, bars and takeaways have had to increase prices to cope with rising operating costs such as labour and utilities, as well as the impact of hospitality sector VAT rates reverting back to their previous higher level. As dining out becomes more expensive, cooking and socialising more often at home is an easy and effective way to save money, as many households realised during lockdown.				
#4	Media subscriptions	35%	46%	-6.1	-£1.6bn
	More than a third of consumers (and over half of Gen Z) plan to cut back on their digital subscriptions. Most TV, film and music streaming services can be cancelled or frozen penalty-free in just a few clicks, making it a quick way to reduce monthly outgoings, especially for younger generations who typically have multiple subscriptions.				
#5	Holiday	33%	41%	-7.8	-£5.6bn
	The high value nature of holiday spending puts it among the top five areas consumers will cut back on. However, most consumers still plan to go on holiday in 2022, with cheaper destinations or staycations the preferred cut back option. After two years of travel restrictions, pent-up demand for holidays remains strong and cancelling plans is considered to be a last resort apart from those on the lowest incomes.				
#6	Household goods	32%	41%	-5.4	-£2.1bn
	Household goods covers big-ticket items such as furniture, but also smaller homeware items that are more budget friendly. While many will think twice before outlaying on a new sofa or dining table in the current environment, affordable cosmetic purchases are less of a priority to cut back on. Consumers have higher expectations of their homes since the pandemic and continue to look for ways to improve living spaces.				

Rank	Sector	Cut back, % of all households	Cut back, % of those planning to spend on this	Cut back, % of annual household spend	Cut back total, £ billion
#7	Beauty	31%	39%	-4.3	-£0.9bn
	One in three (31%) plan to cut back spending on beauty products and services, rising to 43% for women. Much of this cut back is expected to target luxuries such as a beauty treatment rather than skincare or cosmetics that are part of a daily beauty regime. The latter represent small indulgent purchases that can be a morale-booster in times of economic hardship (eg demand for lipstick historically proves resilient during recessions). Brand loyalty is also high in the beauty space with many consumers reluctant to trade down or compromise their physical appearance.				
#8	DIY & Gardening	27%	36%	-4.3	-£0.8bn
	Consumers will cut back on more discretionary DIY spending, for example by putting major home renovations on hold. However, DIY spending is often made up of distress purchases that are difficult to defer as they are needed to fix something. For those able and willing, DIY is also much cheaper than hiring a tradesman or replacing with brand new.				
#9	Electricals	26%	34%	-3.9	-£0.5bn
	A quarter of households plan to cut back on electricals (eg TV, laptop, washing machine) due to the cost of living crisis. Although high value items, electricals are typically cyclical purchases with a relatively long lifespan. Given that many consumers bought new devices and appliances during the pandemic for home working and entertainment, they had not planned to spend significantly in this area anyway. Of those that do intend to purchase this year, 34% will now cut back.				
#10	Fitness	17%	45%	-2.6	-£0.3bn
	While only 17% of households overall plan to cut back on their fitness spending, this represents 45% of those who regularly spend on gym memberships and fitness classes. Consumers are increasingly health conscious, with fitness a key part of routines for many, but nearly half of gymgoers are considering pausing or cancelling their gym memberships in order to cut back.				
#11	Insurance	15%	19%	-2.1	-£0.7bn
	Most households do not perceive insurance (eg home, car) to be a viable area of spending to cut back on. People may shop around and seek cheaper deals upon renewal but consumers are generally reluctant to leave themselves less well protected.				
#12	Pets	14%	21%	-2.0	-£0.2bn
	As cherished members of the household, only around a fifth of pet owners plan to cut back on food, toys or veterinary bills for their pets – the lowest of any of the discretionary spending categories.				

Discretionary spending cut-back represents planned cut-back across all categories except grocery, which totals £24.9 billion

Cut Back sector focus

Food and grocery: widespread cutbacks



One in two UK shoppers are cutting back on their grocery spending

The average household plans to economise on their food shop by

13%

Projected sector cut back:

£13.9bn

The weekly food shop is at the forefront of the Cut Back Economy. One in two UK shoppers are cutting back on food and groceries, more than any other retail and leisure sector. By trading down and economising basket sizes, the average household is looking to cut back £494, or £41 per month, on their food shop over the twelve months to April 2023.

Cut back intentions for food and grocery are highest among low-income households and the under 45s. The weekly food shop accounts for a significant proportion of spending budgets for these households, often young families with more dependents.

Our research shows two thirds (65%) of households living with children plan to cut back spending on their weekly food shop, compared to half for those without.

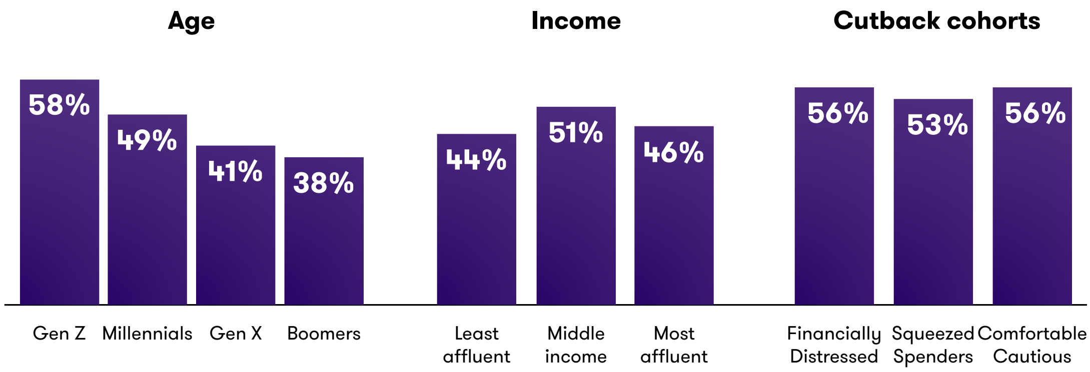
For most consumers, cutting back on the weekly food shop will involve switching to cheaper private-label brands or discounters (52%), making better use of loyalty cards/vouchers (40%) and buying in bulk more frequently (32%).

Major supermarkets are reporting widespread changes in shopper behaviour, including smaller basket sizes and customers self-imposing spending limits as they try to stick within their budgets. Spend on seasonal events such as Christmas will also be impacted, with shoppers unlikely to indulge as normal on premium products.

Financially Distressed households must go even further. A third of consumers in this cohort have already resorted to cutting back food consumption by eating fewer or cheaper meals this year due to cost of living pressures.

Cut Back sector focus

Fashion: Middle to higher income households cut back on new clothes



58%

of Gen Z shoppers plan to cut back on fashion purchases

The average household is looking to reduce their annual clothing spending by

11%

Projected sector cut back:

£3.7bn

Among discretionary spending categories, clothing and footwear is at the top of consumers' cut back priorities. Just under half of all UK households intend to reduce their spending on fashion during the cost-of-living crisis, with the average household aiming to cut back 10.6% of their apparel purchases.

Fashion retail has enjoyed a stellar bounce back over the last twelve months, driven by the return of social events, holidays and office working as pandemic restrictions eased. However, the sector's recovery is now at risk, with the autumn and winter season set to be challenging for retailers as cost of living pressures intensify in the months ahead.

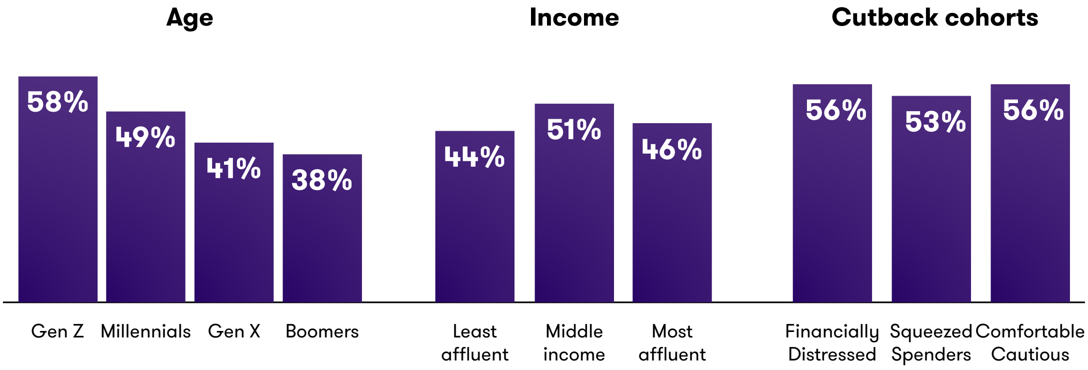
Consumers cutting back on fashion intend to do so by shopping for new clothes less often (47%) and conduct more research and price comparison (45%) before committing to a purchase.

Unlike groceries, the cut back in Fashion will be driven by middle-to-higher income households, rather than the least affluent. For low-income households, affordability already governs their customer journeys. Even in 'normal times' they have less scope to cut back as they already typically shop around for the best deals. Middle-to-higher income consumers have more opportunities to cut back in fashion as their spending habits are less considered, more impulse-driven, and more likely to be focused on premium brands.

Around three in five (58%) Gen Z (18-24 years old) shoppers plan to cut back on apparel purchases – more than any other age group. A third are open to switching to a different brand or retailer in return for lower prices. With margins already squeezed, this poses a challenge for fashion brands targeting younger generations, as price will emerge as a more compelling competitive differentiator.

Cut Back sector focus

Hospitality and leisure: Younger generations to rein in socialising and experiences



Three in five under 45s plan to cut back on dining out

The average household is expected to cut back on hospitality and leisure spending by

9.3%

Projected sector cut back:

£8.5bn

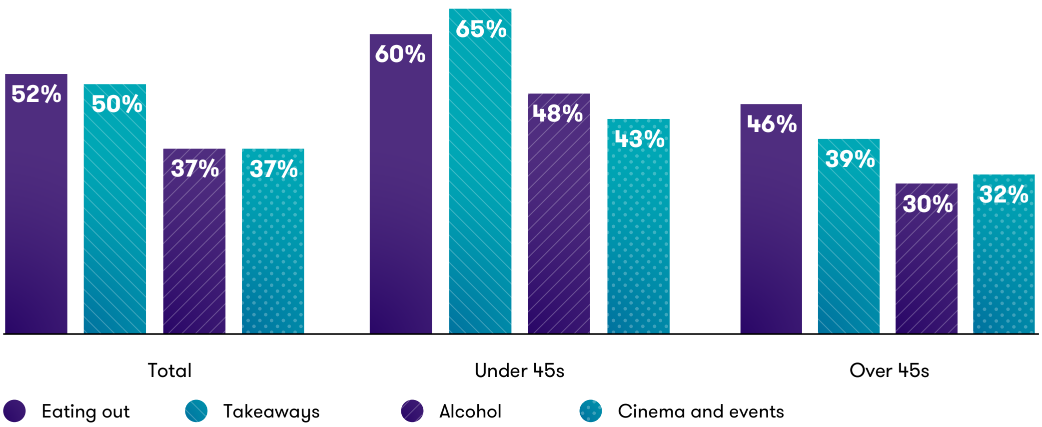
44% of UK consumers plan to cut back on hospitality and leisure spending to counter rising living costs. The average household is expected to cut back 9.3% of their spending on restaurants, bars and cinemas, wiping out a potential £8.3 billion of business across the hospitality and leisure sector this financial year (FY22/23).

This poses a significant challenge to hospitality and catering businesses – already facing rising input costs and staff shortages – which now looks set to face a potentially significant drop in trade.

Looking at sub-sectors within hospitality and leisure, consumers are most likely to cut back spending on restaurants (52%), followed closely by takeaways (50%), while 37% of consumers plan to make cutbacks on alcohol (e.g. pubs, bars) and cinemas, theatres and events.

Under 45s plan to cut back significantly more than older generations across all areas of leisure and hospitality. Although social occasions and experiences are valued highly by Gen Zs and Millennials, their high levels of spending on 'going out' and takeaway treats is no longer sustainable in the current inflationary environment.

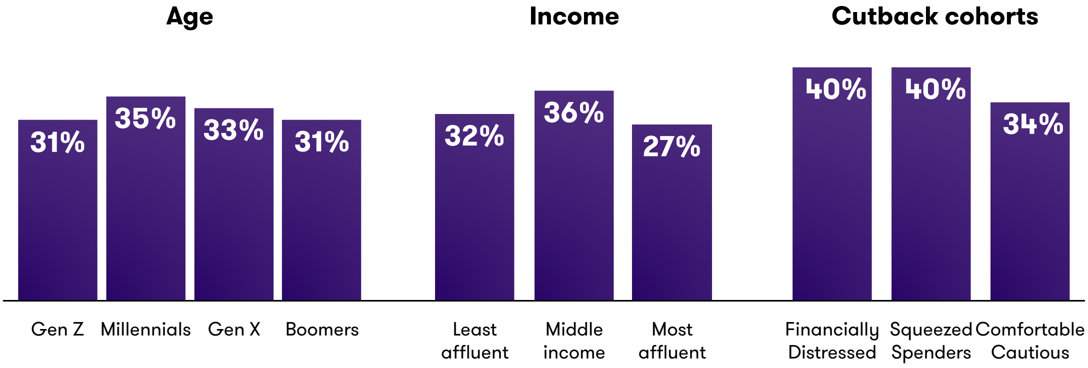
Fig 10. Cut back propensity by hospitality and leisure sub-sector



Source: Retail Economics, Grant Thornton

Cut Back sector focus

Holidays: Most Brits determined to not miss out



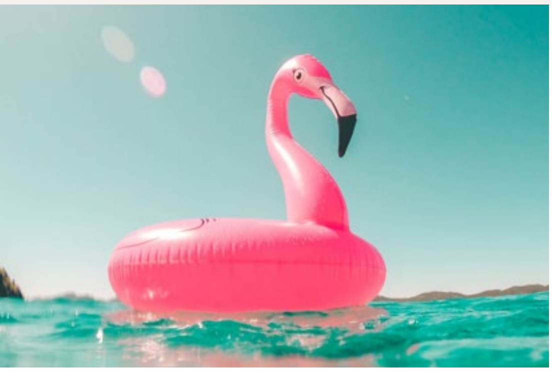
>50%

Over half of households plan to go ahead with their holiday plans in 2022 despite current cost of living pressures

One in four (27%) UK consumers will switch to cheaper holiday package, with less than one in five (16%) cancelling their holiday plans

Projected sector cut back:

£5.6bn



A third of all UK households plan to cut back their holiday spending. Of those that had planned to go on holiday over the next 12 months, 41% expect to spend less than they initially budgeted for. Interestingly, considering that holidays are a big-ticket purchase, it may be surprising that they did not come higher in our Cut Back Economy rankings.

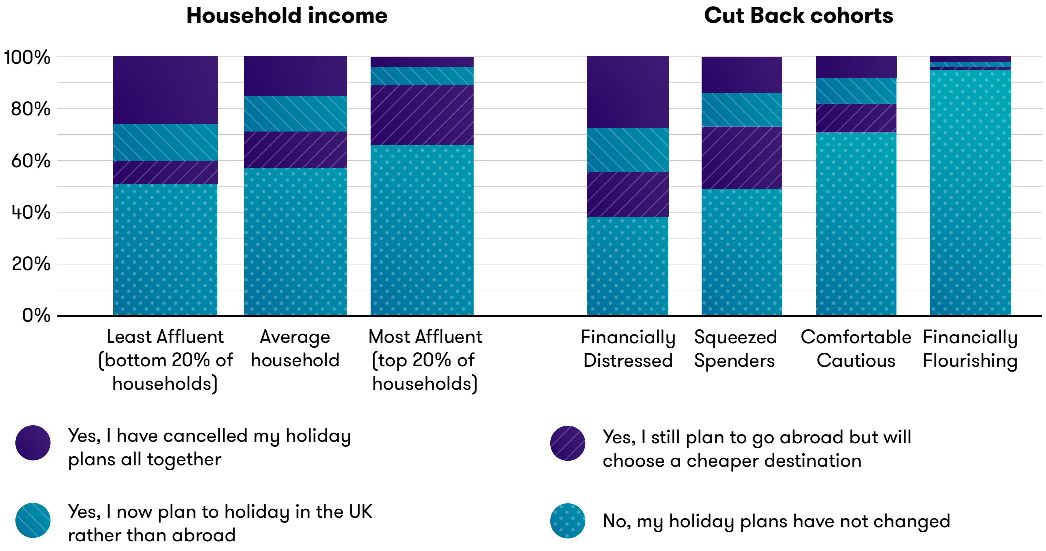
Cutting back on holidays means different things to different people. For example, the least affluent are four times more likely than the wealthiest consumers to have already cancelled their holiday plans for this year, due to rising living costs.

Thinking about immediate holiday plans, most (66%) higher income households are not prepared to make any changes due to the cost of living crisis. And those that are currently cutting back will just switch to a cheaper destination abroad, with very few opting for a staycation in the UK (7%) or cancelling altogether (4%) (fig 11).

Intuitively, there is strong pent-up demand for holidays after nearly two years of travel restrictions, while economic and geopolitical uncertainty is also likely to be intensifying the need for consumers to 'get away from it all', regardless of pressure on household budgets.

Demand is strong across all age groups, but notably for younger generations who are unwilling to sacrifice their travel ambitions. Three quarters of Gen Z (76%) consumers are prepared to cut back their spending in other areas so they can afford a holiday this year, three times more likely than Boomers (24%).

Fig 11. Have you changed your holiday plans because of financial pressures this year?



Source: Retail Economics, Grant Thornton

Cut Back behaviours

As consumers seek value for money from their retail and leisure experiences, the customer journey will become more complex and considered. Consumers will increasingly be open to scaling back spending, switching brands, and shopping around for deals. A deep understanding of these changing behaviours is critical for retailers and leisure operators to leverage emerging opportunities.

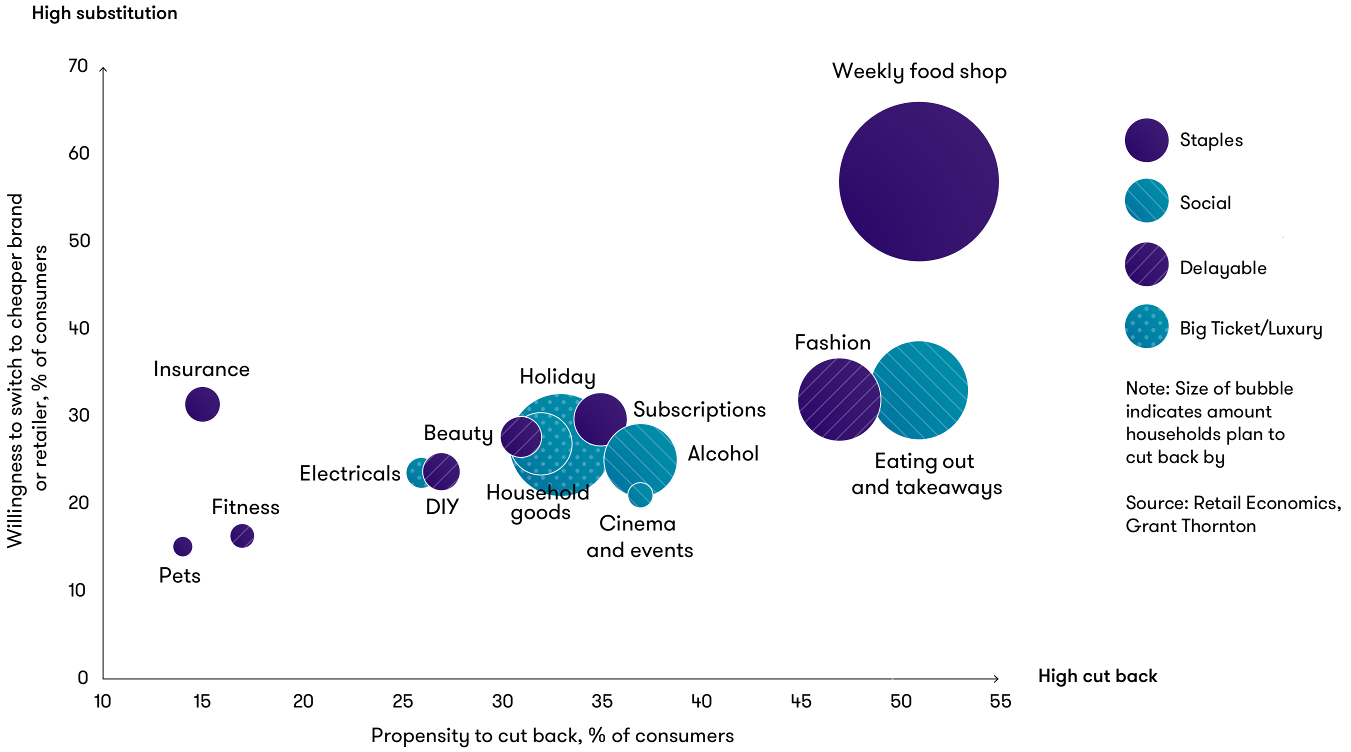
Substitution

Substitution is the most common cutback strategy adopted by consumers, with around one in two consumers actively switching to cheaper brands, retailers, or service operators to combat cost pressures.

However, the willingness to trade down to cheaper alternatives varies considerably by retail and leisure category (fig 12). More staple or social areas of expenditure (eg weekly food shop, restaurants and takeaways) are at risk of greater levels of substitution compared to more limiting areas for trade down options (eg cinemas, gyms), or where brand loyalty tends to be higher (eg electricals, pet supplies).

The bubble chart shows a correlation between propensity to cut back and willingness to switch to a cheaper brand. This suggests that consumers are more likely to cut back in sectors where they spend regularly and have greater ability/choice to trade down.

Fig 12. Consumers more likely to cut back in sectors where they spend regularly and have greater options to trade down



In the above chart, staples includes weekly food shop, pets, insurance and subscriptions.

Scale back

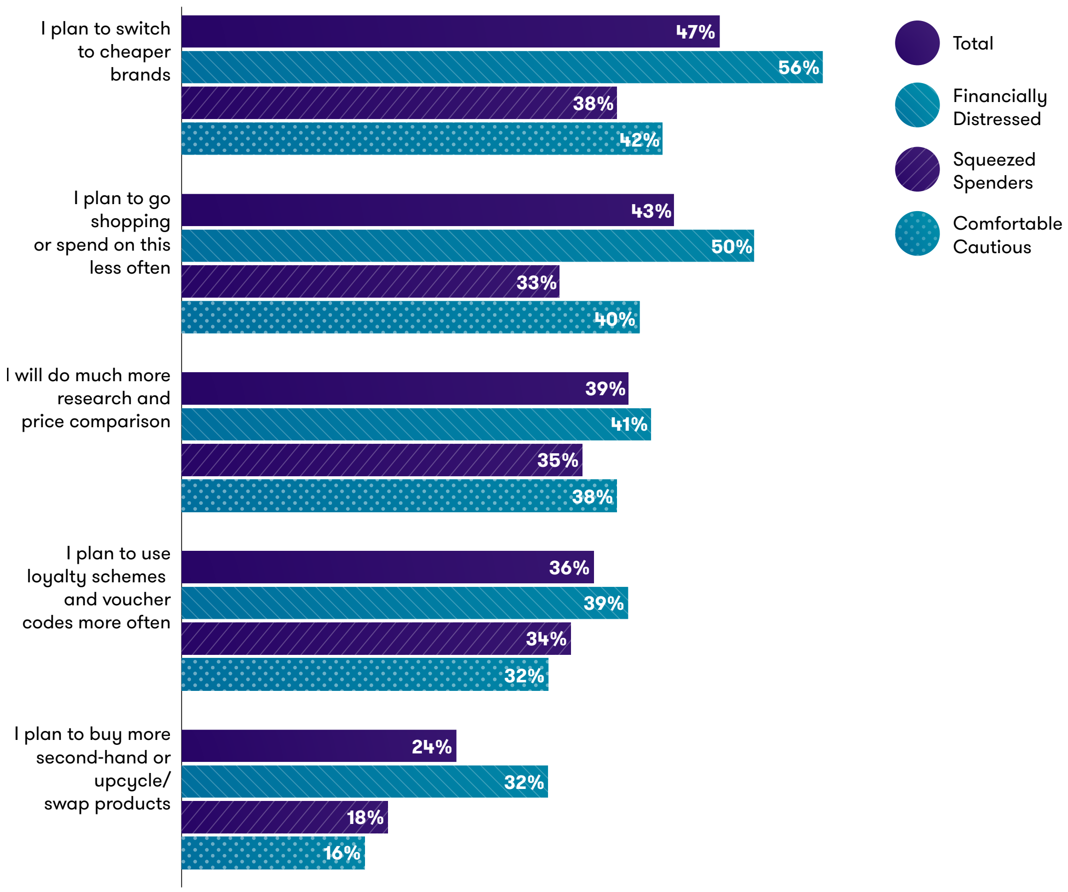
43% of consumers plan to go shopping less frequently in response to the cost-of-living crisis. This has obvious implications for footfall, as retailers and leisure operators will need to provide stronger incentives for consumers to visit their stores or pay for their services.

Financially Distressed households are most likely to reduce the frequency of shopping trips. Interestingly, the Comfortable Cautious cohort intend to scale back on shopping trips and trade down more frequently than Squeezed Spenders, despite being more financially stable (fig 13). This shows the psychological impact the cost-of-living crisis is having on consumers, with emotional concerns driving intentions to cut back.

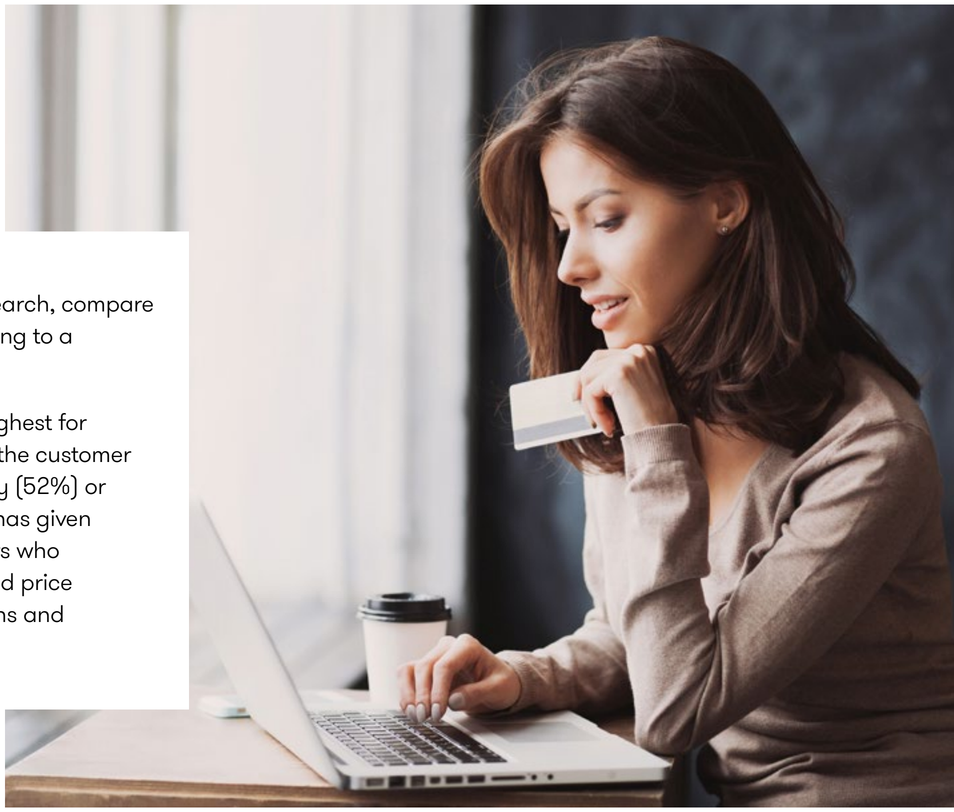
Our research also shows that a quarter of UK consumers plan to buy second-hand (or upcycled) more often, suggesting that the cost of living may inadvertently help accelerate the shift to a circular economy.

The resale or 'pre-loved' market offers an affordable shopping option to cash strapped shoppers, but also meets growing desires from consumers to minimise their impact on the environment as they become more conscious of issues around overconsumption.

Fig 13. Cut Back behaviours by cohort



Source: Retail Economics, Grant Thornton



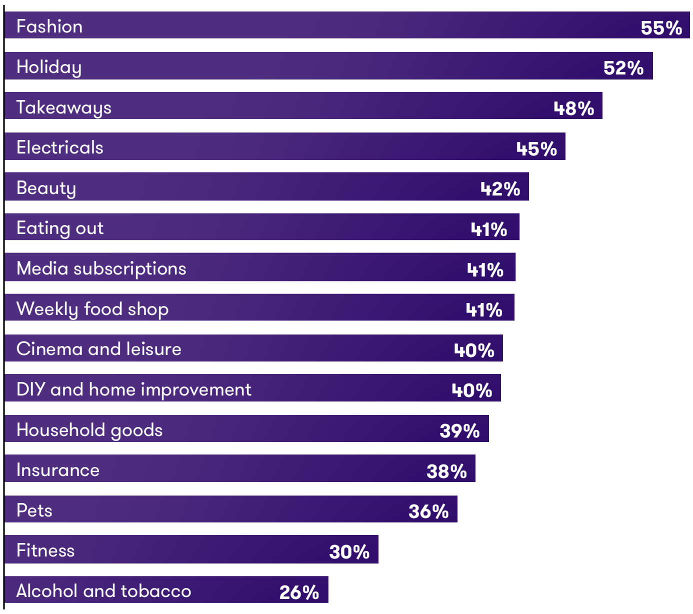
Shop around

Two in five shoppers (39%) intend to do more research, compare prices and shop around for deals before committing to a purchase in the current inflationary environment.

The propensity to research and shop around is highest for categories where online plays a dominant role in the customer journey, such as fashion (55%), booking a holiday (52%) or ordering a takeaway (48%). Digital acceleration has given additional power and greater choice to consumers who increasingly use social media, search engines, and price comparison tools to inform decisions, find bargains and overcome the 'tyranny of choice'.

Fig 14. Consumers more likely to shop around in categories where digital channels play a key role in the customer journey

Proportion of consumers planning to do more research and price comparison



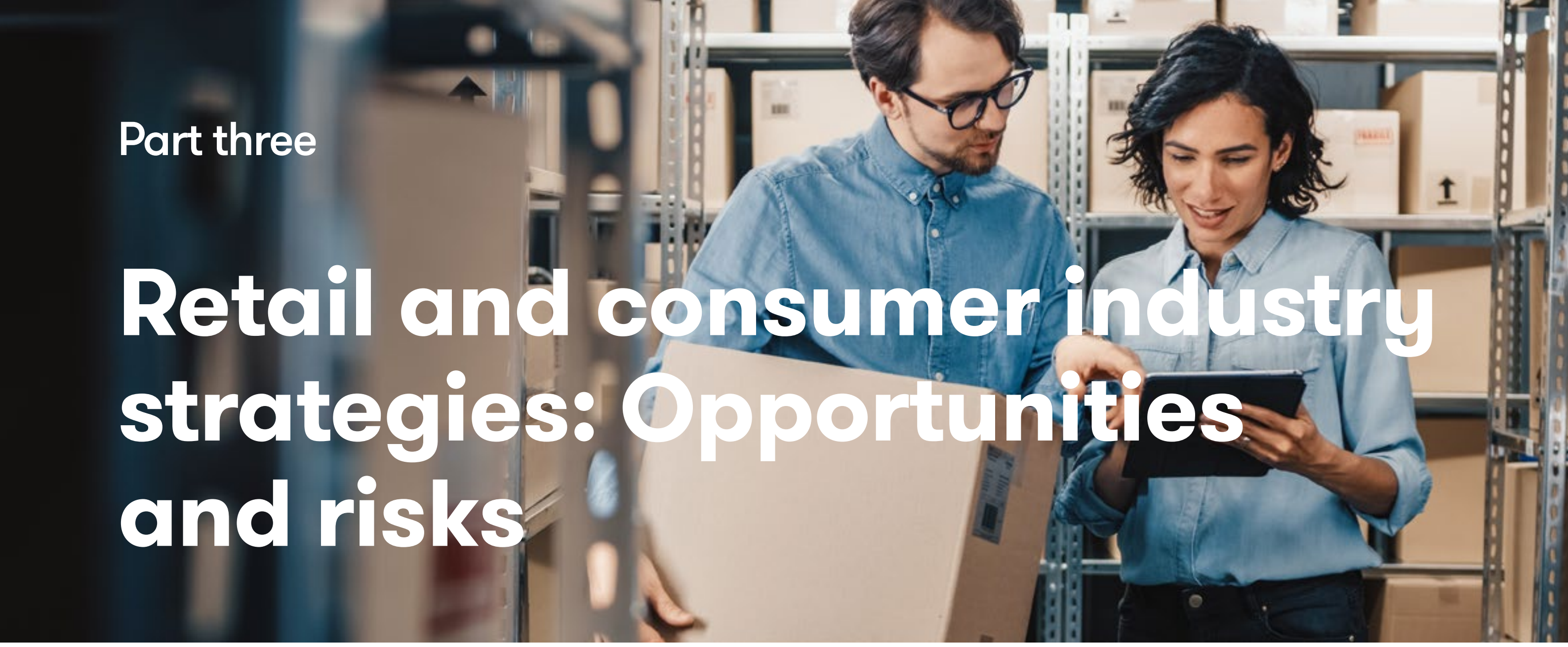
Source: Retail Economics, Grant Thornton

When a shopper decides upon a particular brand and the purchasing decision has been made, there are additional cut back behaviours consumers are likely to adopt. For example, more than a third (36%) of consumers plan to use loyalty schemes and vouchers more often when making a purchase, while a similar proportion (31%) will look to buy in bulk for a better deal, where possible.

However, less than 10% of consumers plan to use credit or buy now pay later schemes more often, suggesting a reluctance among households to take on more debt for discretionary spending.

Part three

Retail and consumer industry strategies: Opportunities and risks



This section explores how companies will need to adapt their propositions to differentiate themselves from the competition and maintain relevancy as a more cost-conscious consumer emerges. Our research identifies five key areas that retailers and consumer-facing businesses can focus on (and invest in) to help mitigate the impact of the Cut Back Economy.

Customer-centricity to secure lifetime value

In an environment of heightened customer expectations and reduced loyalty, it has never been more important for businesses to focus on building customer lifetime value. Fundamentally, successful consumer-facing businesses are customer-centric – they sell products and services that are both desirable and show value for money. This has always been the recipe for success, but as the cost-of-living crisis intensifies, the requirement to demonstrate these factors becomes more pressing.

Retailers and leisure operators must deeply understand their consumers and the economic circumstances they face and adapt accordingly. Successful businesses will not only acknowledge that people are feeling the pinch, but offer ways to help them mitigate the challenges. This will generate goodwill, with consumers more likely to remember and reward those businesses that helped them through the biggest squeeze in disposable income in decades.

As more cost-conscious consumers emerge, loyalty scheme benefits will become more valued and integrated into the customer journey, influencing how and where consumers shop. Although loyalty schemes largely aim to incentivise purchases and return visits through discounts and promotions, offering better, more personalised rewards will be key as the cost-of-living squeeze tightens.

From a customer perspective for example, having instant access to lower prices across a wide range of products, in-store and online, is a more compelling loyalty scheme (e.g. Tesco Clubcard, Boots Price Advantage), than traditional physical vouchers or points-based system where benefits are harder to obtain.

Loyalty apps can also be an effective way for retailers to provide a seamless, digitalised shopping experience, giving consumers the opportunity to unlock unique rewards and promotions, obtain product information and choose their preferred delivery option.

However, loyalty schemes should be viewed as one element in a comprehensive package of value driving initiatives built upon granular knowledge of customer wants and needs.

Data-driven decision making

Consumer-facing businesses must ensure they have the capabilities to embrace the powerful insights that can be gleaned from their customer data. Investment in data science and digital transformation is essential to ensuring that any strategic decision-making is strongly data-driven.

Advanced data analytics can help retailers gain a competitive advantage by providing actionable and near real-time insights into how customers are responding to cost of living pressures. With the right digital tools, retailers can leverage enormous swathes of data on their customers – their buying habits, locations, product preferences, delivery schedules, levels of spend and more.

Data harvesting (eg social media 'listening' or AI-driven insights) can quickly identify the most profitable customer base from customer segmentation and profiling. It also allows a deeper understanding of customers' needs and requirements to predict future behaviour and demand.

Data-driven decision making will also allow for a more agile, sophisticated price and promotional strategy, something that will be an invaluable tool as the cost-of-living crisis plays out.

However, data analytics requires specialist skillsets which many retailers and leisure operators lack. In such a competitive labour market, talent acquisition can be expensive and time-consuming. Outsourcing and forming new partnerships with brands that have greater expertise in the digital space can be an effective way to overcome this.

Competitive-price-positioning

As recessionary behaviours and cutting back becomes the priority for consumers, businesses must ensure they anchor their proposition around value for money, while offering relevant ranges across channels in a highly competitive market.

In a fiercely competitive market, UK retailers and leisure operators work hard and find creative ways to holding back passing the bulk of rising costs onto customers in order to remain competitive.

However, the emergence of the Cut Back Economy makes it more imperative that businesses invest in competitive pricing and build a strong value proposition. This means working with suppliers to limit price rises or step-up promotional activity, while ensuring that product quality is maintained.

Consumers will not be sympathetic to steep price rises, especially if they are not meaningfully communicated to them. Striking a balance between using the right tone with a core customer base, while simultaneously attracting new cohorts who are willing to try new brands will be key in protecting market share.

There is an opportunity for retailers to focus efforts on reaching 'drifting' consumers as they explore new brands, trade down, and shop around for deals in response to rising living costs. For shoppers under intense financial pressure, offering compelling entry level price points across relevant ranges with price matching is likely to be the most effective approach.

For luxury or premium brands targeting more affluent customers, the focus should be on emphasising the perceived value gap to make downtrading less appealing. For example, communicating product or service aspects that may justify higher price points such as superior quality, sustainability, innovation or exclusivity.

A laser-like focus on pricing architecture is vital for retailers and consumer brands in the cut back economy, providing choice to customers across different price points while protecting brand image.

Rethinking supply chains

Alongside a cost-of-living crisis, manufacturing delays, shipping backlogs and labour shortages are adding additional layers of cost and supply chain complexity for consumer-facing businesses. While it's difficult to predict how long and to what extent these challenges will last, there is an opportunity for retail and leisure operators to review their supply chain strategies for additional robustness.

Improved strategies will require regaining control and visibility over supply chains, including diversifying suppliers, implementing cutting-edge inventory management, and collaborating with logistics providers to build greater flexibility to secure supply.

Diversification

Using shorter, more flexible supply chains that are better equipped to deal with supply shocks will help reduce reliance on single countries or manufacturers. However, moves towards on-shoring or near-shoring can impact margins due to local cost differences. Businesses will need to gain an understanding of these differences to build pricing scenarios and avoid inventory write-offs.

Digitalisation

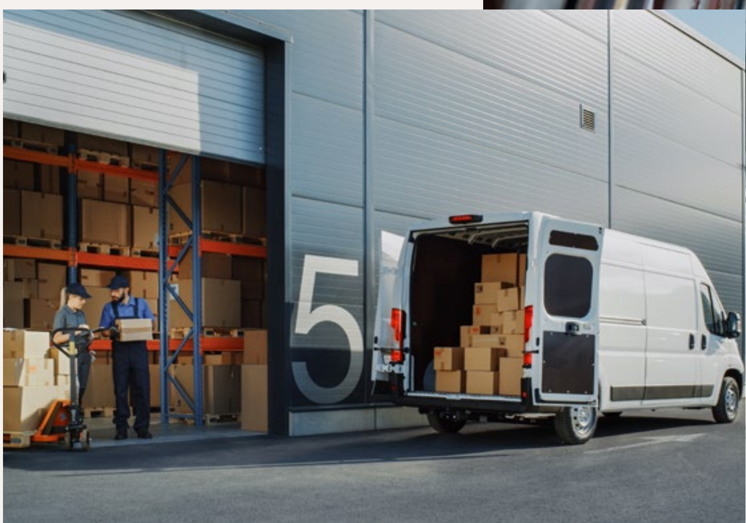
Increased efficiency and predictability can be achieved through the digital transformation of supply chains. From point of sale to predictive ordering, digital supply chain transparency can help optimise product mix, reduce waste, and adapt pricing to meet market dynamics.

Inventory management

Establish alternative supply sources to enable fast-tracked volume delivery capability. Adopt better, more agile inventory policies to maintain 'just-in-time' strategies with established mitigation.

Last mile

Consumer expectations for cheap and speedy delivery has become normalised. Consistently achieving these objectives will require investment towards more automated distribution centres and micro-fulfilment hubs (and potentially ship-from-store) to meet this shift in demand at scale.



Implementing the ESG agenda

Retailers and consumer businesses must not lose sight of longer-term Environmental, Social and Governance (ESG) goals, despite the current cost and margin pressures. In fact, the more progressive and proactive brands will be remodelling strategies and implementing changes that link wider ESG agendas to the cost-of-living crisis.

For example, near-shoring supply chains and sourcing goods locally can help create operations that are more resilient to external factors such as inflation or fluctuating shipping costs, as well as reducing the environmental impact of international logistics. Retailers should be looking to near-shore sourcing as a cost benefit to themselves, but also to support local communities and strengthen their ESG messaging to consumers.

Our research shows that, even in the current inflationary environment, almost half (48%) of UK shoppers are willing to pay more for sustainable products. This reflects the rising expectation that ethical credentials and policies around sustainability are a 'must' for consumer-facing brands, and not something that consumers are prepared to sacrifice.

Consumer purchasing habits are increasingly shaped by responsible consumption and the desire to 'do good'. Consumers are also more mindful of what they buy, how products are manufactured, and where materials and ingredients are sourced.

The growth of clothing and furniture rentals (eg Hirestreet, My Wardrobe HQ, Selfridges Rental, IKEA), online resale platforms (eg Depop, Vinted), and the wider circular economy are prime examples of how these trends are bringing about new commercial opportunities.

However, different generations have different ESG priorities. Our research shows that older consumers are more concerned that consumer-facing brands pay a fair wage to their employees, while local sourcing is also valued highly. In comparison, younger Gen Z consumers are most concerned about climate change and reducing their carbon footprint. Messaging around net zero and carbon reduction resonate most with Gen Zs, with around one in five saying that carbon reduction is the most important ethical practice for consumer brands to get right, compared to around one in 10 Boomers.

ESG will remain a priority for retailers who will need to navigate consumer spending pressures, legislation and reporting requirements, alongside growing investor activism. Business leaders have a short window of opportunity to take the lead on issues such as CO_2 emissions, fair pay, packaging and waste, otherwise their actions will be forced by government regulations that will likely prove more costly in the long run.

Conclusion

Retail and consumer-facing businesses now face a very different crisis as surging inflation and geopolitical instability heralds the arrival of the Cut Back Economy.

Our research shows that 9 in 10 UK consumers intend to cut back spending amid sharp rises in the cost of living. With the average household set to cut back £887 of their discretionary spending through to April 2023, UK retail and consumer industries are at risk of losing out on £24.9 billion of spending this financial year.

Within the Cut Back Economy, households will react differently depending on their age, income and persona. Our research identifies four distinct consumer archetypes: 'Financially Distressed'; 'Comfortable Cautious'; 'Squeezed Spenders'; and 'Financially Immune', all with their distinct characteristics.

Rising inflation and political instability amongst other factors have pushed society into a cost-of-living crisis, the worst of its kind for generations with full impacts yet to emerge.

Against this backdrop, many consumers are already changing their behaviours and reprioritising their spending ambitions as they decide which products, channels and brands represent best value for money. There are specific differences at a category level, with the grocery, fashion, and hospitality & leisure at the forefront of consumers' cut back intentions.

The research also highlights five focus areas in which retail and consumer brands need to pay close attention to in response to changing consumer behaviour within the cut back economy. These include: customer-centricity to secure lifetime value; data-driven decision making; competitive price positioning; rethinking supply chains; and the ESG agenda.

By implementing sophisticated strategies and agile operating models that demonstrate a deep understanding of the Cut Back Economy and how consumer behaviour will likely play out, retailers and consumer-facing businesses can ride the waves of disruption and convert opportunities into solid growth.

Many consumers are already changing their behaviours and reprioritising their spending ambitions as they decide which products, channels and brands represent best value for money.

RetailEconomics

Get in touch

Nicola Sartori
Partner, Head of M&A Retail and Consumer Brands
nicola.a.sartori@uk.gt.com

Senthil Alagar
Restructuring Partner
senthil.alagar@uk.gt.com

Emily Cheevers
Audit Partner
emily.cheevers@uk.gt.com

Lee Holloway
Tax Partner
lee.holloway@uk.gt.com

Grant Thornton

grantthornton.co.uk

DS3640